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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1934.

No. 340

OLD COMPANY'S LEHIGH, INC.,
*Petitioner,*

—against—

HENRY E. MEEKER, as Receiver, for the First National Bank in Mamaroneck, THE FIRST NATIONAL BANK IN MAMARONECK, and R. G. BREWER, INC.,
*Respondents.*

## REPLY BRIEF OF PETITIONER.

ISRAEL H. MANDEL,
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*Attorney for Petitioner.*

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## *REPLY BRIEF OF PETITIONER.*

### *Statement.*

This reply brief by the petitioner is being filed in answer to the brief of the respondent receiver on which brief the attorneys for the Comptroller of the Currency appear of counsel. The petitioner, in this reply brief, will avoid arguing further on the question of the validity of Section 350-1, Subdivision 2, Article 19-A, of the New York Negotiable Instruments Law, commonly known as the Uniform Bank Collection Code, since petitioner believes that that issue has been fully covered in Argument I of the petitioner's original brief herein.

With respect to this question we merely wish to comment briefly upon the reversal by the Circuit Court of Appeals of the District Court decision of

*Royal Mfg. Company* v. *Spradlin*, 6 F. Supp. 98, which reversal was not reported at the time of the filing of the original brief by the petitioner herein. We believe that the reversal by the Circuit Court of the *Spradlin* case does not alter the force of the reasoning urged by the petitioner herein in Argument I of the original brief. An examination of the North Carolina Statute which is recited in full in the Circuit Court opinion indicates that it is materially different from the statute known as the Uniform Bank Collection Code which is involved in the instant case. In fact, the opinion of the Circuit Court indicates that the North Carolina Statute, under consideration in said case, is composed of twenty-three subsections, all of which relate to the liquidation of state banks. The Uniform Bank Collection Code which is involved in the instant case, on the other hand, deals with the bank as a going concern and creates a lien based upon the contract of collection, which lien comes into being before the insolvency takes place. The Uniform Bank Collection Code, therefore, does not attempt to regulate the distribution of the assets of an insolvent national bank and therefore does not conflict with the Act of Congress (12 U. S. C. A., § 194).

In filing this reply brief, the petitioner's main purpose is to clarify the principles of equity which should govern the determination of this case, since the petitioner believes that these well settled principles of equity have been completely overlooked by the Court below in this case, and have been erroneously conceived in the respondent's brief.

## ARGUMENT I.

**Disregarding, for the sake of the argument, the question of the validity of the Uniform Bank Collection Code, the claim of the petitioner which is urged on the equity side and is based on pure equity, cannot be defeated by the purely legal rights of the ordinary creditors of the bank.**

The respondent's statement (p. 5) that all issues must be resolved in favor of the bank receiver does not apply in the instant case, since the instant case does not come before this Court after trial but only upon the pleadings of the petitioner. The petitioner is entitled to all favorable inferences that might be drawn from its pleadings, and therefore all doubts at the present time must be resolved in favor of the petitioner and not in favor of the bank receiver. It is not until trial is actually had that any presumption could arise that the petitioner had or had not failed to meet the burden of proof by a fair preponderance of the evidence.

The respondent lightly brushes aside the arguments of the petitioner in favor of the application of the "as if" doctrine and claims that it would be resorting to fiction to apply that doctrine. Respondent further asserts that "this is not a novel contention" (p. 12). However, neither is it a novel contention to urge a court of equity not to consider that done which in good conscience ought to be done by the simple accusation that its relief is based on the resort to fiction. The history of the development of equity indicates that the courts of equity, from the times of the early Chancellors, have never been persuaded against applying the Divine principles of

morality, in cases where the law did not afford an adequate remedy, because the cry was raised that it would be resorting to fiction to look at the substance of things rather than the form.

It is worth noting, at this point, that the respondent does not hesitate to urge a more obvious fiction, in his effort to defeat the petitioner's rights, namely, the fiction of transforming the undisputed relationship between the petitioner and the collecting bank from that of principal and agent, trustee and *cestui que trust,* to that of ordinary debtor and creditor.

The Circuit Court of Appeals, for the Fifth Circuit, in its first decision in the case of *City of Miami* v. *First National Bank of St. Petersburg, Florida,* 58 F. (2d) 561, highly commends the dissenting opinion of Mr. Justice Faris, in the case of *Larabee Flour Mills* v. *First National Bank of Henryetta, Okla.* (C. C. A.—8th Dist., June 12, 1926), 13 F. (2d), page 332. We believe that Mr. Justice Faris, in said dissenting opinion, tore away the veil of confusion created by the failure of some of the Federal courts to apply the well settled principles of equity, in cases of this character, when a bank receives a draft for collection and remittance from a stranger, who is not a depositor of the collecting bank.

We cite from the dissenting opinion of Judge Faris as follows:

> "But the state courts quite generally hold that, when a bank receives a draft for collection and remittance, and of course from a stranger, who is not a depositor of the collecting bank, and accepts in payment for such draft a check drawn on itself, a trust fund in favor of the drawer is thereby created, which

fund may be followed and recovered in full from the receiver of such bank, if the latter shall become insolvent. *Hawaiian Pineapple Co.* v. *Browne*, 69 Mont. 140, 220 P. 1114; *State National Bank* v. *First National Bank*, 124 Ark. 531, 187 S. W. 673; *Goodyear Tire and Rubber Co.* v. *Bank*, 109 Kan. 772, 204 P. 992, 21 A. L. R. 677; *Bank of Poplar Bluff* v. *Millspaugh* (Mo. Sup.) 281 S. W. 733.

On the other hand, the federal courts quite generally hold that the test of recovery as a preferred claim is whether by the transaction the assets of the insolvent bank, passing into the hands of the receiver, are increased; and they reach the conclusion that payment of such a draft by a depositor of the collecting bank, by a check of such depositor on his account in the collecting bank, does not serve to increase the assets coming into the receiver's hands, but merely operates to make the drawer the creditor of the bank instead of the drawee.

That the latter view is obviously sound when the drawer is already a depositor—that is, a creditor of the collecting bank—is borne out both by reason and authority. For, when a depositor of a bank draws a draft and deposits it for collection and credit, the relation of debtor and creditor is created between such a drawer and the collecting bank, and that title of the proceeds of the draft passes to the bank. Thereafter, the matter is one of ordinary debt, and such a debt is not a preferred claim.

*But when a stranger draws a draft for collection and remittance of the proceeds to the drawer, no such relation of debtor and creditor is created, and the title to the proceeds of the draft does not pass to the bank. Nyssa Arcadia Drainage Dist.* v. *First National Bank* (D.

C.) 3 F. (2d) 648; *Commercial Bank* v. *Armstrong,* 148 U. S. 50, 13 S. Ct. 533, 37 L. Ed. 363; *Sweeney* v. *Easter,* 1 Wall. 166, 17 L. Ed. 681. On the contrary the cases seem to hold that the bank becomes an agent and trustee for the drawer, and in such relation, it takes and holds the proceeds of the draft. *If without title and against the will of the drawer, who is its principal and cestui que trust, the bank may pocket this trust fund and pass it on to its creditors, the situation would seem novel and anomalous, and opposed to all general principles governing agency and trusteeship. Holder* v. *Western German Bank,* 136 F. 90, 68 C. C. A. 554.

A great majority of the cases wherein the federal court doctrine is laid down are cases in which the relation of debtor and creditor, as between the drawer and the collecting bank, already existed, yet many of these cases unnecessarily lay down the doctrine of the necessity of an augmentation of assets. *Beard* v. *Independent, etc., Dist.,* 88 F. 875, 31 C. C. A. 562; *Clark, etc., Co.* v. *American Bank,* 230 F. 738; *City Bank* v. *Blackmore,* 75 F. 771, 21 C. C. A. 514, *Nyssa etc., District* v. *Bank* (D. C.) 3 F. (2d) 648; *Franklin, etc., Bank* v. *Beal* (C. C.) 49 F. 606; *Jewett* v. *Yardley* (C. C.) 81 F. 920." (Italics ours.)

The learned Justice then points out that the later cases have abandoned the doctrine that no recovery can be had where the defaulting trustee commingles the trust fund with his other assets and proceeds to discuss the augmentation rule, as follows:

"The rule which requires an augmentation of assets as a condition precedent to putting in motion the numerous equities conceded to

exist in favor of the drawer of a draft sent for collection and returns was seemingly announced originally without setting out any definite or satisfactory legal foundation, or any reason at all, for its existence. If it rests, as was said years after it was announced, upon the doctrine that one who has many equities in his favor, stands in no better case than one who has but one equity in his favor (*Empire State Surety Co.* v. *Carroll County,* 194 F. loc. cit. 603, 114 C. C. A. 435), *I am, with much regret, unable to agree; for, while the claims of the appellant and ordinary creditors here are being urged on the equity side, yet the right of the drawer is a pure equity and the rights of the ordinary creditors between whom and the appellant the contest actually is, are purely legal. The latter is trying to fasten a trust on a definite fund, while the former, as ordinary creditors, are trying to recover money due them from their creditor, the insolvent bank, out of any fund possible.*

It is conceded that the great weight of authority in the Federal courts, even disregarding what I may call debtor and creditor cases, which I do not regard as in point, is in favor of the rule that recovery depends on whether there has occurred augmentation of assets through the transaction which occurred, and that when a draft held by a bank for collection is paid by the drawee with a check on the collecting bank, there is no such augmentation of assets, but a mere switching of creditors. *But I am not able to see how this fact has any such legal relevancy as to put the equities in favor of the strange drawer on a parity with those of the ordinary depositors of the bank. The latter became the willing creditors of the bank, the former, if he does become a creditor,*

*becomes such without his consent and against his expressed intent.* Many fairly well settled principles announced in the very cases which require such augmentation, and in many others besides, seems utterly at variance with the above rule. Some of these principles, so at variance are: (a) That in case of a draft deposited for collection and returns no title ever passes to the collecting bank (*Nyssa, etc., District* v. *Bank, supra*); (b) That the bank takes the collection as an agent for the drawer (*American Can Co.* v. *Williams,* 178 F. 420, 101 C. C. A. 634; *Clark etc. Co.* v. *Bank* (D. C.), 230 F. 738); (c) That it takes the collection as the trustee of the drawer (*Holder* v. *Bank,* 136 F. 90, 68 C. C. A. 554); (d) That the collecting bank is bound to accept only legal tender, to wit, money, in payment of such a draft (*Bank* v. *Fed. Reserve Bank* (C. C. A.), 6 F. (2d) 339; *Fed. Reserve Bank* v. *Malloy,* 264 U. S. 165, 44 S. Ct. 296, 68 L. Ed. 617, 31 A. L. R. 1261; *Bradley Lumber Co.* v. *Bank* (C. C. A.), 206 F. 41), and (e) That, if it mingles such a fund with its own funds, the proceeds may yet be followed (*Peters* v. *Bain,* 133 U. S. 670, 10 S. Ct. 354, 33 L. Ed. 696), and *ceteris paribus,* recovered.

I am led to believe that the error (if it is an error, and I cannot see it otherwise) has arisen from too closely following debtor and creditor cases, in which the doctrine requiring augmentation of assets was early, but unnecessarily announced, and by the laying down of an erroneous initial premise, even if, *arguendo,* the correctness of the legal conclusion that there must be an augmentation of assets, be conceded. *This error is, I submit, that the courts which have squarely so held* (*Anheuser-Busch Ass'n* v. *Clayton,* 56 F. 759, 6 C. C. A.

108; *American Can Co.* v. *Williams*, 178 F. 420, 101 C. C. A. 634; *Clark, etc., Co.* v. *Americus Bank, supra; Anadorko, etc., Co.* v. *Litteer* (D. C.), 300 F. 222) *have considered the situation which existed as of the time when the draft was paid to the collecting bank by a check of the drawee on such bank, and not the situation which existed when the receiver took over the assets; that is to say, the bank, while it was a going concern, paid the drawee an amount of its debt due him equal to the draft it held for collection against him, and therefore, with such transaction, so far as the receiver was concerned, he was not concerned at all, since his rights did not attach till after the transaction between the collecting bank and the drawee was a closed incident.*" (Italics ours.)

The respondent argues that the equities of the depositors are at least equal to those of the petitioner (p. 28). This is the only reason urged as to why equity should not consider that done which in good conscience ought to be done. In other words, if the depositors of this insolvent national bank do not have equities equal to those of the petitioner, a court of equity would consider the transaction as if the maker of the note had actually cashed his check and paid the cash back over the counter to the teller, in which event the said amount would have constituted an identifiable trust *res* which had passed into the hands of the receiver and which belonged to the petitioner. We, therefore, believe that the determination of the instant case, in favor of the petitioner, depends entirely upon the comparison of those equities which exist in favor of the petitioner with those claimed in favor of the depositors of the insolvent bank.

We respectfully submit that the depositors are but ordinary creditors of the insolvent bank. There is no fiduciary relationship existing between the depositors and the bank, and therefore no equities exist herein in favor of the depositors. Their rights are purely legal rights based upon their debtor and creditor relationship with the bank. On the other hand, the rights of the petitioner herein are purely equitable rights arising out of the fiduciary relationship of principal and agent existing between the petitioner and the bank.

The opinion of the Circuit Court, in the case at bar, expressly holds that whatever the bank collected upon the note was held in trust for the petitioner and, if traced into the hands of the receiver, might be reclaimed (T. 25).

Furthermore, with respect to the second cause of action, had the agent collecting bank performed its duty and had held the note of its principal, the petitioner herein, until its date of maturity, January 16th, 1933 and had not released it two days prior thereto on January 14th, the principal could have reclaimed from the receiver the original note which would have passed into the receiver's hands since the bank was not opened for business on January 16th, the date of the maturity of the note. In substitution for the note, the wrongdoing agent has received from its depositor a check to itself for like amount and has discharged its liability to its depositor for that amount. By that transaction the collecting bank ceased to be its depositor's debtor for that amount so that the general deposit credited to its depositor was accordingly reduced. It could not in turn become the mere debtor of the owner of the note because the contract for collection and remittance did not contemplate a debtor and creditor relationship but on the contrary imposed

the strict fiduciary relationship of principal and agent, trustee and *cestui que trust.* Whatever bookkeeping entries the bank might be authorized to make with respect to its own depositors, it certainly could not by a mere bookkeeping entry transform itself from agent and trustee to that of a simple debtor, as far as its principal was concerned. Equity should intervene in favor of the innocent principal. In equity, the principal is the equitable owner of this special fund. The depositors are ordinary creditors whose rights to this special trust fund are no greater than those of the wrongdoing trustee, the agent collecting bank.

The argument of the respondent (p. 28) that the "as if" doctrine should not be applied in this case because it was not applied in the case of *Blakey* v. *Brinson,* 286 U. S. 254, is completely answered by the fact that the *Blakey* case dealt with the rights of a bank and its depositor between whom a debtor and creditor relationship had existed from the inception, while, in the case at bar, no debtor and creditor relationship had ever existed, or was ever contemplated between the petitioner and the bank, and, on the contrary, the relationship was that of principal and agent, trustee and *cestui que trust* from the very inception. It must also be remembered that in the *Blakey* case this Court indicated no disapproval of the "as if" doctrine if the procedure followed by the parties established a basis for the inference that the establishment of a trust fund was contemplated.

It is, beyond dispute, that the equities of the petitioner are superior to any equities in favor of the depositors, since no equities exist in favor of the depositors, their rights being purely legal rights. However, if, for the sake of the argument, we should

assume that there are equities existing in favor of the depositors, we cannot depart from the fact that such equities are, at the most, only equal to the equities existing in favor of the petitioner. Though equal equities be granted to the depositors and other creditors of the bank, the petitioner is still entitled to prevail because where the equities are equal, the first in time will prevail.

*Salem Trust Co.* v. *Manufacturers' Finance Co.*, 264 U. S. 182;
*Commercial Investment Trust* v. *Bay City Bank*, 62 F. (2d) 735;
*Judson* v. *Corcoran*, 17 How. 612, 15 L. Ed. 231.

There is no question that the equities in favor of the petitioner arose at the moment that the bank accepted the check of its depositor and released the note of the petitioner to its depositor. At that moment, the transaction became complete and all equities in favor of the petitioner immediately came into being. At that time, the bank was a going concern. No equities at that time existed in favor of its depositors because its depositors were ordinary creditors of the bank and the bank was open for business. Any equities that might arise in favor of the depositors of the bank did not come into being until the subsequent closing of the bank and the consequent transfer of its assets to the receiver took place.

If we are to conclude that the rights, in equity, of the depositors who are ordinary creditors of the bank are equal to those of the petitioner towards whom the bank stood in a fiduciary capacity, we must first obliterate completely, from our minds, the

glorious history of equity beginning from the time of the early Chancellors, who laid down the foundations of equity, and who were constantly appealing to and governed by the principles of absolute right, guided by their conscience, and inspired by a lofty morality, based upon the Divine principles of what is right and what is wrong.

***We, therefore, respectfully submit that the superior equities existing in favor of the petitioner warrant the application by a Court of Equity of the "as if" doctrine, in favor of the petitioner, and consequently there has been traced into the hands of the receiver an identifiable trust res belonging to the petitioner.***

Respectfully submitted,

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